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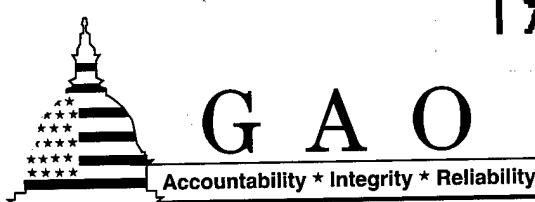
Enterprise Funds' Contributions to Private Sector Development Vary



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National Security and
International Affairs Division

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The Honorable Benjamin A. Gilman
Chairman, Committee on International Relations
House of Representatives

The Honorable Doug Bereuter
Chairman, Subcommittee on Asia and the Pacific
Committee on International Relations
House of Representatives

In 1989, the United States authorized enterprise funds as an experimental model to support private sector development in selected countries of Central and Eastern Europe as they transition from centrally planned to market-oriented economies.¹ The funds, which are private, nonprofit U.S. corporations, are supposed to make loans to, or investments in, small- and medium-sized businesses in which other financial institutions are reluctant to invest. With the breakup of the Soviet Union in 1991, enterprise funds were subsequently established in the newly independent states. Currently, 10 funds operate in Central Europe and the former Soviet Union, covering 19 countries with authorized funding of about \$1.3 billion.² Enterprise funds receive their funding through the U.S. Agency for International Development (USAID), and USAID has primary responsibility for monitoring the funds' operations.

At your request, we determined (1) whether enterprise funds are assisting private sector development; (2) what factors have affected the funds' ability to carry out their activities; (3) whether funds still have a role in private sector development, given other private investment and international donor efforts; (4) whether the funds are likely to recoup their

¹The Support for East European Democracy (SEED) Act of 1989 (P.L. 101-179) authorized the creation of enterprise funds in Poland and Hungary. Later, under the SEED Act and the FREEDOM Support Act of 1992 (P.L. 102-511), eight additional funds were established in Central and Eastern Europe and the former Soviet Union. We reported on the first four enterprise funds in March 1994; see Enterprise Funds: Evolving Models for Private Sector Development in Central and Eastern Europe (GAO/NSIAD-94-77, Mar. 9, 1994).

²Four funds operate in multiple countries. The Baltic fund includes Estonia, Latvia, and Lithuania; the Central Asian fund covers Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan; the Czech-Slovak fund operates primarily in the Slovak Republic, but also covers the Czech Republic; and the Western Newly Independent States fund covers Belarus, Moldova, and Ukraine.

authorized capital; and (5) whether the funds are complying with recent changes in USAID reporting requirements. In a separate letter, we address issues related to "spin-off" venture capital organizations that the Polish fund helped establish as well as U.S. government plans to use funds generated from the sale of Polish fund assets to help establish a foundation for further private sector development in Poland and to return some funds to the U.S. Treasury.³

Differing economic conditions and legal and regulatory environments in each country and the length of time the respective funds have been operational make comparisons across funds difficult. To gain additional perspective and first-hand knowledge of fund operations, we visited the Russian and Romanian funds' in-country offices; toured investment sites; and met with U.S., host government, and fund officials. Both funds have been operational for about 4 to 5 years, with Russia being the largest fund (\$440 million in authorized capital) and Romania one of the smaller funds (\$50 million). Although the report contains information related to all 10 funds, we primarily relied on our examination of these 2 funds to address your interest in the continued relevance of enterprise funds. We also describe their investments, loans, and technical assistance activities in appendixes I and II, respectively.

Results in Brief

To varying degrees, enterprise funds in Central Europe and the former Soviet Union have engaged in investment activities that support private sector development in their host countries. Taken together, the 10 enterprise funds have made investments and loans in and provided technical assistance mainly to small- and medium-sized businesses totaling about \$809 million through fiscal year 1998, using capital authorized in U.S. grants as well as investment proceeds. Nine funds have raised additional investment capital from investment partners on individual deals or by establishing private equity funds that attracted other investors. Capital raised this way totaled about \$744 million, according to USAID. Most of the funds have taken steps to help strengthen financial institutions and encourage economic reforms. For example, the Polish, Russian, and Romanian funds trained bank personnel in credit risk evaluation and provided financing to small businesses; the Polish and Russian funds initiated residential mortgage programs that did not previously exist in

³See Foreign Assistance: Issues Concerning the Polish-American Enterprise Fund (GAO/OGC-99-61R, Sept. 14, 1999).

their host countries; and the Polish, Romanian, and Albanian funds invested in host-country banks.

Fund management and host-country legal, regulatory, and economic climates were key factors in the funds' ability to carry out their activities. According to U.S. and fund officials, the Polish fund was able to invest in the private sector and attract additional capital because, at least in part, the board and senior fund managers worked well together from the outset in managing the fund's assets. In contrast, U.S. officials characterized the Russian fund as slow to begin investing because its fund managers were not initially located in-country and were not involved on a daily basis with fund operations. Other key factors included the recent Asian and Russian financial crises, which frightened away many private investors and curtailed some of the funds' investment activities, and, according to Russian fund officials, frequent changes in Russia's legal and tax codes, which made it difficult for the funds to enter into timely investment contracts.

Based on our analysis of financial and investment patterns in Russia and Romania, the enterprise funds in both countries have a continuing development role for the foreseeable future. Despite private and international donor investments in these countries, the overall need for foreign investment capital and western business expertise in Russia and Romania continues unabated. For example, due in large measure to the recent financial crises, International Monetary Fund (IMF) statistics indicate that foreign direct investment in Russia decreased by 65 percent in 1998, underscoring the need for the fund's continued involvement. Furthermore, the nature of most foreign investment in Russia is different from much of the Russian fund's investments. Among other things, other foreign investment is predominantly in stocks and bonds and does not involve the direct transfer of western management skills. In contrast, the Russian fund has focused on making direct investments in an attempt to influence long-term business and management reforms in the private sector.

Determining whether enterprise funds will recoup their authorized capital is difficult because funds have 10- to 15-year life spans and, thus, long maturity periods for their investments. Enterprise funds are venture capital-type funds that involve an inherent risk of financial loss—individual investments will fail, but, in the long term, successful ventures are supposed to offset the losses. Although the Polish fund has not sold all its investments, it has finished making new investments and is expected to

recover its original authorized capital. Similarly, USAID officials expect the Hungarian and Romanian funds to recoup their authorized capital as well. In contrast, while the Czech-Slovak fund has not finished making new investments, U.S. and fund officials say that its early losses make it unlikely that the fund can recoup its authorized capital.

The enterprise funds were reporting financial and related information, as required. In 1997, USAID increased enterprise fund reporting requirements due to congressional concerns about the extent to which the U.S. government was monitoring fund progress, using a standard set of indicators. USAID now requires each fund to prepare a "strategic framework matrix" with multiyear investment projections and break-even analyses, as well as information on other key areas, such as investments in small- and medium-sized firms and other private capital raised.

Background

Enterprise funds are governed by boards of directors consisting of private citizens of the United States and host countries that have experience in areas such as investment banking or have geographical and other relevant expertise (see app. III). The fund boards are responsible for establishing their own operating and investment policies and directing their corporate affairs in accordance with U.S. legislation and grant agreements. The funds' senior managers are generally American. The funds' investment staffs, including senior investment officers and other investment professionals, are comprised of combinations of American, host-country, and third-country national employees. The funds are generally supposed to target viable small- to medium-sized private businesses in the funds' host countries. However, the Russian fund has the flexibility to invest in medium- to large-sized companies as well.⁴ The funds can invest in start-up companies and privatized state-owned enterprises, and can invest solely or through joint ventures and separate private equity funds that attract other U.S., host-country, third-country, or multilateral organization investors.

The Department of State Coordinators of Assistance for Eastern Europe and the New Independent States are responsible for overall coordination of assistance activities in the region and are responsible for overseeing

⁴The Russian fund was created in 1995 through the merger of two already existing funds—the Russian-American Enterprise Fund and the Fund for Large Enterprises in Russia—incorporated in 1993 and 1994, respectively. The first fund was supposed to operate like other enterprise funds, but the second focused on larger businesses and had less of a development focus than the others. When the two funds were merged, the new Russian fund assumed the roles of both.

enterprise funds on policy and other matters arising outside of the funds' grant agreements. USAID oversees the funds' operations.

Funds Are Assisting Private Sector Development

The enterprise funds have assisted private sector development in their host countries primarily by making investments and loans in and providing technical assistance to small- and medium-sized businesses, using capital authorized in U.S. grants and fund investment proceeds. Nearly all the funds have also raised additional investment capital by finding investment partners or establishing separate private equity funds that attract outside investors; however, the amounts of capital varied widely. Most of the funds have taken measures to help strengthen financial institutions and provide a "demonstration effect" that encourages economic reforms through new, market-oriented activities in their host countries, although the types and extent of such efforts varied among the funds.

Making and Providing Investments, Loans, and Technical Assistance

The 10 enterprise funds in Central Europe and the former Soviet Union have made investments and loans and provided technical assistance primarily to small- and medium-sized businesses totaling about \$809 million as of September 30, 1998. Some funds have invested more than their authorized capital, using additional monies generated through their investment activities, while others have invested less than their authorized capital. For example, as of September 30, 1998, the Polish fund had received nearly all of its \$264 million in authorized capital and invested about \$300 million, using a combination of its authorized capital and monies generated from investment proceeds. The Polish fund has stopped making new investments with U.S. grant funds and has begun liquidating some of its investments. As of the same date, the Hungarian fund had also received about 80 percent of its \$72.5 million in authorized capital and invested about \$81 million, also using a combination of both authorized capital and monies generated through investment activities. The Russian fund had received over one-third of its \$440 million in authorized capital and invested about \$125 million. The Romanian fund had received almost 70 percent of its \$50 million in authorized capital and made investments totaling about \$35 million. It is important to note that the funds are at varying stages of their life spans—in 1998, the Polish and Hungarian funds were in their eighth years of operation, while the Romanian and Russian funds were in their fourth and fifth years, respectively.

Most funds have also used funding to provide technical assistance to businesses in which they invest. Funds have provided employee training,

upgraded management information and financial reporting systems, and provided advice and technical support in a variety of other areas to such firms. However, according to USAID officials, funds often do not identify technical assistance activities separately from their investment activities, when such assistance is provided in support of specific investments. Therefore, figures shown for technical assistance provided do not fully reflect some funds' actual technical assistance activities. Table 1 shows the amount of capital authorized in USAID grants for each fund and the amounts that each of them invested or specifically identified as technical assistance provided as of September 30, 1998.

Table 1: Enterprise Fund Capital Authorized and Invested and Technical Assistance Provided as of September 30, 1998

Dollars in millions					
Enterprise Fund	Year incorporated	Capital authorized in USAID grants	Capital invested ^a	Technical assistance	Total capital invested and technical assistance
Hungary	1990	\$72.5	\$75.0	\$6.2	\$81.2
Poland	1990	264.0	284.0	16.8	300.8
Czech-Slovak	1991	65.0	39.3	3.1	42.4
Bulgaria	1992	55.0	49.0	1.8	50.8
Russia	1993	440.0	123.3	1.7	125.0
Baltic	1994	50.0	25.1	1.7	26.8
Central Asia	1994	150.0	76.7	0	76.7
Romania	1994	50.0	33.7	1.0	34.7
Western Newly Independent States	1994	150.0	48.7	3.5	52.2
Albania	1995	30.0	18.3	0.3	18.6
Total		\$1,326.5	\$773.1	\$36.1	\$809.2

^aThe amount of capital that funds invest can include monies generated through investment activities and, thus, can be larger than the amount of authorized capital received from USAID grants.

Source: USAID.

Most of the funds' investment activities are focused on a wide range of small- and medium-sized enterprises. However, the Russian fund has the flexibility to invest in somewhat larger enterprises. For example, the Russian fund's largest project was a \$15.5-million direct investment in a brewing company. The average size of the fund's 28 equity investments as of September 30, 1998, was about \$3.5 million. The Russian fund has invested in diverse industries, ranging from agribusiness to pharmaceuticals. The average size of the Romanian fund's 16 direct

investments as of the same date was \$1.5 million. The Romanian fund has also invested in diverse areas, ranging from financial services to construction materials. Both of these funds also target much smaller companies through their various loan programs. For example, the average size of the Russian fund's 282 small business loans was about \$75,000, and the average size of the Romanian fund's 61 such loans was about \$63,000.

Raising Capital From Other Sources

In addition to their authorized capital, nearly all funds have raised additional outside capital through the involvement of other investors. For example, according to USAID, the Polish fund has raised additional capital of at least \$328 million through a combination of finding outside investment partners for individual deals and helping establish separate private equity funds that attracted outside investors. The Romanian and Hungarian funds have raised \$80 million and \$50 million, respectively, through a similar combination of methods. The Russian fund raised capital from outside investment partners totaling approximately \$244 million. In contrast, the Baltic fund has not raised any outside private capital. Table 2 details the amount of capital raised from outside sources by each fund as a percentage of its authorized capital in USAID grants.

Table 2: Fund Capital Raised From Other Sources as a Percentage of Authorized Capital as of September 30, 1998

Dollars in millions					
Enterprise fund	Year incorporated	Capital authorized in USAID grants	Capital raised from other sources	Other capital as a percent of authorized capital	
Hungary	1990	\$72.5	\$50.0	69	
Poland	1990	264.0	328.0	124	
Czech-Slovak	1991	65.0	3.4	5	
Bulgaria	1992	55.0	20.1	37	
Russia	1993	440.0	244.3	56	
Baltic	1994	50.0	0	0	
Central Asia	1994	150.0	2.9	2	
Romania	1994	50.0	80.0	160	
Western Newly Independent States	1994	150.0	15.2	10	
Albania	1995	30.0	0.4	1	
Total		\$1,326.5	\$744.3	56	

Source: USAID and enterprise funds.

Strengthening Financial Institutions and Encouraging Economic Reforms	Most of the funds have taken measures to help strengthen financial institutions and provide a "demonstration effect" that encourages economic reforms through new, market-oriented activities in their host countries, although the types and extent of such efforts vary among the funds. All but the Western Newly Independent States fund have worked to strengthen financial institutions by undertaking activities such as training bank personnel and providing financing to businesses through partner banks. All but the Czech-Slovak fund have provided a demonstration effect through activities such as delivering capital to previously underserved segments of the economy or establishing previously nonexistent market institutions such as mortgage and micro-sized loan programs. Table 3 lists some of the activities in which funds have engaged.
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Table 3: Examples of Fund Activities to Strengthen Financial Institutions and Provide a Demonstration Effect

Enterprise fund	Strengthening financial institutions	Demonstration effect
Albania	Established (and wholly owns) the American Bank of Albania.	Established the American Bank of Albania, the first western-style bank in Albania.
Baltic	Established a residential mortgage program that was replicated by banks.	Established a residential mortgage program that was replicated by banks; also one of few lenders to provide small- and medium-sized loans, ^a emphasizing women and rural areas.
Bulgaria	Established (and wholly owns) the Bulgarian-American Credit Bank, which serves as a conduit for fund investments.	Created Home Mortgage Lending Program; also one of few sources for medium-term financing (focusing on real estate and hotels).
Central Asia	Established (and wholly owns) the Asian Crossroads Loan Company, which serves as a conduit for loans to small- and medium-sized businesses.	Created micro- and small-sized loan programs. ^a
Czech-Slovak	Trained about 50 bankers in the loan application development process.	None.
Hungary	Created micro- and small-sized loan programs that have been replicated by commercial banks.	Established the Hungarian Innovative Technologies Fund, the first in the region devoted exclusively to funding small entrepreneurs and developing innovative technologies.
Poland	Created First Polish-American Bank; also trained bankers in western-style corporate governance and financial management systems.	Established Polish-American Mortgage Bank for residential mortgages; also provided capital to housing developers.
Romania	Purchased Banca Romaneasca, which serves as a conduit for small- and medium-sized loan program; also trained bank personnel in cash-flow lending techniques.	Established micro-, small-, and medium-sized loan programs, ^a the only such funding mechanisms available to Romanian entrepreneurs.

(continued)

Enterprise fund	Strengthening financial institutions	Demonstration effect
Russia	Used Russian "partner banks" for small- and medium-sized loan program; also trained bank personnel in credit methodology and underwriting.	Established one of the first residential mortgage programs and the first auto loan program in Russia; also operates micro-, small-, and medium-sized loan programs. ^a
Western Newly Independent States	None.	Received the first-ever license for a non-depository financial institution to make loans and leases in Ukraine.

^aEnterprise fund micro-, small-, and medium-sized loans vary in size and other characteristics among the funds, including the two where we conducted case studies. The Russian fund's micro-sized loan program involves loans of between \$1,000 and \$20,000 to enterprises with fewer than 20 employees, and its small-sized loan program involves loans of up to \$150,000 to businesses with fewer than 100 employees. The Romanian fund's micro-sized loan program involves loans of between \$2,500 and \$15,000 (with no requirement regarding the number of employees), and its small- and medium-sized loan program involves loans of up to \$150,000 to businesses with 200 or fewer employees.

Source: USAID and enterprise funds.

As illustrated in table 3, some funds have helped strengthen financial institutions by assisting selected banks. For example, the Russian and Romanian funds have developed relationships with "partner banks" and use these banks to implement loan programs. The Russian fund is providing technical assistance by training bank personnel in credit methodology and underwriting as well as other key skills. The Romanian fund has implemented training programs for bank staff that allow the consideration of a firm's earnings history and profit potential rather than using only a company's assets to determine loan eligibility, as Romanian banks had done in the past.

Funds have also invested in host-country banks as a method of strengthening financial institutions. For example, the Polish fund bought a controlling interest in a Polish bank and then merged the bank's operations with the fund's small business loan program. The Romanian fund invested about \$5 million and is now the majority shareholder in a private Romanian bank with 12 branches throughout the country. Since taking controlling interest in the bank in December 1998, the Romanian fund now utilizes the bank as its partner institution to implement its entire small- and medium-sized loan program. The Albanian fund recently opened a bank that is wholly owned by the Albanian fund.

Funds have provided capital to previously underserved segments of the economy. For example, the small- and medium-sized loans that the Russian and Romanian funds offer address a segment of the economy not previously served by financial institutions. According to Romanian and Russian fund officials, banks in their host countries traditionally made little effort to provide loans to small entrepreneurs, preferring to make loans to

large companies or to invest their capital in instruments such as government securities.

Funds have also established previously nonexistent market institutions. For example, the Polish fund pioneered the concept of home mortgage lending in Poland and operates the Polish-American Mortgage Bank as a subsidiary of the fund. The Russian fund also operates a residential mortgage lending program and initiated the first auto loan program of its kind in Russia. The Romanian fund established a micro-sized loan program—a new lending mechanism in Romania. The fund implements the program through two U.S.-based, nongovernmental organizations, which have provided micro-sized loans to enterprises in many sectors of the economy, such as manufacturing, trade, and services.

Fund Management and Host-Country Conditions Affect Funds' Activities

Fund management's early involvement in fund activities and host-country conditions play key roles in the funds' ability to execute their activities. Fund management was a key factor in the success of the Polish fund and the early losses of the Czech-Slovak fund, and affected the investment pace at the two funds where we conducted case studies—Russia and Romania. The legal and regulatory environment and economic conditions in the funds' host countries affected fund operations as well.

Fund Management

USAID, State, and fund officials agreed that enterprise fund management plays a critical role in the funds' ability to execute their activities—especially at the outset. According to USAID and State officials, the Polish fund's success was due in part to having a well-functioning board of directors and good management from the beginning. Conversely, the officials said that a poor investment strategy and mismanagement of the Czech-Slovak fund's resources were major factors in that fund's early losses. One USAID evaluation cited the fund's decision to avoid the service and retail sectors of the economy as one reason the fund had not performed better financially. Another pointed to management's insufficient supervision of its investments and an operational strategy that emphasized saving costs over maintaining staffing continuity. Eventually, the entire board of directors was replaced, and the fund essentially terminated its activities in the Czech Republic, concentrating its remaining activities in the Slovak Republic.

Our case studies in Russia and Romania highlighted fund management's influence on investment pace. Fund officials in Romania told us that policy

and operational disagreements by board members and management delayed investment decisions and adversely affected staff morale. However, after key changes in management and on the board of directors, the pace of investment and staff morale improved. Russian fund officers and USAID and State officials said that an absence of in-country leadership and frequent senior management turnover contributed to the Russian fund's early slowness to invest. For example, fund officials in the United States and Russia told us that leadership and management turmoil had delayed the Russian fund's investment progress from 12 to 18 months. The current Chief Operating Officer of the Russian fund lives in-country, and fund officers and USAID and State officials told us that the fund's operations had improved significantly as a result of this change.

In an attempt to measure management efficiency, we also examined the funds' operating expenses as a percent of their capital. Fund and private sector officials told us that private sector venture capital funds typically charge a management fee of 2 to 2.5 percent of authorized capital throughout the life of the fund to manage the fund. The combined rate of operating expenses for all enterprise funds was 2.8 percent during 1998. However, as shown in table 4, the rates varied widely from fund to fund. Fund and private sector officials said that operating expenses are normally higher than 2.5 percent during the initial years of a fund's existence because of start-up costs and lower than 2 percent during the last few years of a fund's life.

Table 4: Enterprise Funds' Operating Expenses as a Percentage of Authorized Capital for 1998

Dollars in millions				
Enterprise fund	Year incorporated	Capital authorized in USAID grants	Operating expenses	Operating expenses as a percent of capital
Hungary	1990	\$72.5	\$2.5	3.4 ^a
Poland	1990	264.0	2.0	0.8 ^a
Czech-Slovak	1991	65.0	1.7	2.6
Bulgaria	1992	55.0	1.8	3.2
Russia	1993	440.0	9.0	2.0
Baltic	1994	50.0	2.7	5.4
Central Asia	1994	150.0	7.5	5.0
Romania	1994	50.0	3.4	6.8
Western Newly Independent States	1994	150.0	6.2	4.1
Albania	1995	30.0	0.8	3.0
Total		\$1,326.5	\$37.7	2.8

^aHungarian and Polish fund operating costs are shared with the funds' associated private equity funds.

Source: USAID and enterprise funds.

Host-country Conditions

Economic conditions and host-country legal and regulatory environments, over which funds have little control, also affected fund operations. Immediately following the August 1998 Russian financial crisis, the Russian fund halted many of its activities for 30 days and focused its efforts on protecting its existing portfolio by restructuring loans and assisting its portfolio companies in developing post-crisis strategies and restructuring plans. Financial documents that we reviewed during our visit to Russia indicated that the 1998 Asian and Russian financial crises had substantially negative effects on nearly all of the Russian fund's portfolio companies. For example, the fund had to increase its loss reserves to about 17 percent of its total direct investment portfolio and 22 percent of its small loan portfolio. As a result, the fund reported loan and investment losses totaling over \$13 million for the fiscal year ended September 30, 1998.

Romanian fund officials told us that high tax rates consume large amounts of private firms' working capital and discourage investment in that country. Similarly, Russian fund officials told us that frequent changes in the Russian legal and tax codes make it time-consuming to address issues of law and taxation in investment contracts. USAID officials told us that poor economic conditions had caused a number of funds to exercise caution in

making investments in order to safeguard fund assets. For example, the Bulgarian fund pursued a cautious investment strategy in the early years of its operations due to economic uncertainties in that country. Later, as economic conditions improved, fund officials accelerated their investment pace.

Russian and Romanian Funds Have a Continuing Development Role

The overall capital needs in Russia and Romania can accommodate the activities of all investors, even with occasional competition. The Russian and Romanian enterprise funds have a continuing development role, despite other private investment flows and other donors that provide equity and debt financing in those countries. For example, foreign investment by private investors in Russia is predominantly portfolio investment in stocks and bonds, without the substantial influence on company operations and transfer of western financial and management expertise that the Russian fund's direct investments entail. Also, the funds' direct investment programs employ different operating approaches and target different market segments than those of other donors.

Capital Needs in Russia and Romania

The overall capital needs in Russia and Romania are large. One way to view a country's capital needs is by considering the country's investment levels in the context of its population. Per capita foreign direct investment in Russia and Romania is relatively less than investment in other countries in the region. For example, IMF statistics indicate that in 1997—the year in which Russia's foreign investment was at its peak—its foreign direct investment was only \$42 per capita compared to \$127 in Poland, where the enterprise fund is only beginning to curtail its operations. Romanian per capita foreign direct investment was \$54 in 1997, less than half of Poland's and slightly more than Russia's.

In 1998, foreign direct investment in Russia decreased significantly due to the Asian and Russian financial crises. The country's \$2.2 billion in foreign direct investment during 1998 was 65 percent less than the \$6.2 billion that it received in 1997. On a per capita basis, 1998 foreign direct investment in Russia was only \$15, compared to \$163 in Poland. USAID, State, and Russian fund officials said that the dramatic drop in foreign direct investment in Russia underscored the need for the fund's continued involvement in that country.

During the first 9 months of 1998, Romania's foreign direct investment was 11 percent less than it was for a comparable period in 1997. However, the

U.N. Economic Commission for Europe reported that the Romanian government sold several large, state-owned enterprises at attractive prices to foreign investors at the end of the year because of its need for funds.⁵ This skewed the 1998 year-end total of foreign direct investment in that country upward to \$1.6 billion, or 32 percent more than the \$1.2 billion that it received in 1997. Despite these unusual investment flows, per capita foreign direct investment in Romania was only \$71 in 1998, less than half of Poland's.

The funds have occasionally competed with other private investors and donors in Russia and Romania. For example, Romanian fund officials said that a private investor made an equity investment in a pharmaceuticals packaging and distribution firm that the fund was prepared to make. The Russian and Romanian funds' small business financing programs' approaches and targets are similar to those of other donors. For example, the European Bank for Reconstruction and Development (EBRD)⁶ has programs in Russia and Romania that provide loans to small businesses through intermediary banks, as do the Russian and Romanian funds. Officials for two companies that we visited in Russia said that they had actively considered similar loans from an intermediary bank associated with EBRD but that they chose the Russian fund's loan because the terms were better and the funding could be provided in a more timely fashion. The International Finance Corporation (IFC)⁷ also has an in-country program that provides loans to small businesses through intermediary banks in Russia. IFC, which recently opened an office in Romania, provided a \$5-million loan commitment to assist the Romanian fund in expanding its small loan program.

Officials from EBRD, IFC, the Russian and Romanian funds, USAID, and State all said that the market for small business financing in Russia and Romania is large enough for all donors. They added that some competition among donor organizations is healthy and normal at the working level. None of these officials said that the competition diminished the relevance of any of their programs. Moreover, Russian fund officials said that the

⁵Economic Survey of Europe, 1999 No. 1 (New York and Geneva: Secretariat of the Economic Commission for Europe, United Nations, 1999), p. 169.

⁶EBRD promotes private sector development through lending, investment, and other activities in 26 countries in Central Europe and the former Soviet Union.

⁷IFC is affiliated with the World Bank and promotes the growth of the private sector through lending, investment, and other activities in its 174 member countries.

competition for individual direct investments has greatly diminished since the Russian and Asian financial crises, when many investors left Russia.

Foreign Investment in Russia

Foreign investment in Russia has been dominated by portfolio investment (stocks and bonds), not direct investment. For example, in 1998, total foreign investment in Russia amounted to \$10.9 billion. Approximately \$8.7 billion, or about 80 percent of this amount, was comprised of portfolio investment, which is oriented toward short-term profits and does not entail investor participation in governing the recipient firms. During the same year, only \$2.2 billion, or about 20 percent of Russia's total foreign investment, consisted of direct investment, which targets long-term opportunities and entails investor involvement in the recipient companies.

In contrast, the Russian fund's equity investments are generally direct investments. Russian fund officials told us that the fund normally attempts to acquire a large enough share in recipient companies to have a significant influence on their operations. The Romanian officials told us that they follow the same approach.⁸ USAID and fund officials consider this type of active involvement as an essential tool for influencing market-oriented reforms in the recipient firms of transition countries.

Other Donor Programs

The funds' direct investment programs tend to make smaller investments, target smaller companies, or employ different investment instruments than other donors. For example, in Russia and Romania, EBRD invests in large infrastructure projects in the form of loans in sectors such as energy and telecommunications as the core of its activity. These projects are generally much larger than the Russian and Romanian funds' equity investments. For example, an EBRD official in Russia told us that the size of the bank's major infrastructure projects range upward to about \$1 billion, whereas the Russian fund's investments range in size from \$75,000 to about \$15 million. In Romania, EBRD's average investment for similar projects is nearly \$64 million, while the Romanian fund's investments range from about \$42,000 to almost \$5 million.

In addition to large infrastructure projects, EBRD has regional venture capital funds that operate in Russia and Romania. However, Russian fund officials told us that the EBRD program targets firms smaller than those

⁸Unlike Russia, foreign direct investment represents the largest share of foreign investment in Romania.

that the fund currently focuses on through its direct investment program. Romanian fund and EBRD officials told us that, although the potential for competition between the fund and EBRD exists because they are targeting similar investments, it has not presented a problem to date because of the large, unsatisfied demand for capital.

IFC has direct investment programs and offices in Russia and Romania. However, according to IFC officials in Russia, IFC does not compete with the Russian fund because IFC's direct investment program targets larger investments than the Russian fund. Further, IFC's investments are in areas such as energy and general manufacturing, which are not areas the fund emphasizes. The largest part of IFC's direct investment program in Romania focuses on public infrastructure projects and other investments that are larger than most enterprise fund investments. IFC provides additional capital to existing private venture capital companies for investments in Romania that are comparable in size to some Romanian fund investments. However, Romanian fund and IFC officials said that these private funds do not compete with the Romanian fund because, like with EBRD, of the large, unsatisfied demand for private equity capital in that country.

The Overseas Private Investment Corporation⁹ (OPIC) also has a private investment fund program that operates in transition countries in Central and Eastern Europe and the former Soviet Union. However, the objectives and focus of its program are different from enterprise funds. OPIC operates its program through existing American venture capital companies, using long-term, secured loan guaranties and loans to help the firms establish and capitalize regional investment funds.¹⁰ OPIC's objective is primarily to support and protect U.S. companies and investors, while enhancing U.S. development objectives and furthering stability in foreign countries. However, the individual private investment funds make commercially based investment decisions in order to realize a profit and do not have the same development mandate as enterprise funds.

⁹OPIC is an independent U.S. government corporation that assists U.S. investors overseas by providing political risk insurance, financing, and other investment services.

¹⁰As of March 31, 1999, including accrued interest, OPIC had made loan guaranties and loans of about \$677 million in Russia and \$22 million in Romania, of which about \$330 million and \$16 million, respectively, had been invested.

Whether Funds Will Recoup Authorized Capital Is Problematic

Current USAID guidance to enterprise funds is that the funds should aim to have assets worth at least the amount of their original grants when they terminate their operations. This expectation has evolved over time. When enterprise funds were first established, many U.S. officials did not expect funds to recoup their original grants. In 1993 and 1994, USAID made changes to its grant agreements with the funds, setting forth options for the use of remaining fund assets upon termination of operations. Over time, as the likelihood increased that some of the more mature funds might recover their original authorized capital, USAID raised the target to the same level for the other funds.

USAID currently expects that at least three funds will recover their authorized capital through their investments and one will not. The Polish fund has finished making new investments with U.S. government funds and has begun to liquidate some of its investments. USAID expects the Polish fund to recover its original authorized capital. The fund's estimated net worth was \$270 million—\$15.5 million more than the amount that it received through its authorized grant—as of September 30, 1998.

Currently, USAID officials also expect the Hungarian and Romanian funds to eventually recoup their original authorized capital. In contrast, although the Czech-Slovak fund has not finished making new investments, it sold the Czech portion of its portfolio at a loss of 92 percent of its invested capital in 1997, making it unlikely that the fund can recoup its original authorized capital when it eventually ceases operations.

For the other funds, determining whether they will ultimately recoup their original authorized capital is not reasonably possible until they are closer to liquidating their investments. According to enterprise fund and other private venture capital officials, markets for the funds' investments—and a way to determine "fair market" value—often do not exist in the transition countries where the funds operate. Also, the funds have intended life spans of 10 to 15 years, and, therefore, potentially long periods for their investments to be profitable. Table 5 shows the funds' assets as of September 30, 1998.

Table 5: Enterprise Funds' Grant Amounts and Estimated Asset Valuation as of September 30, 1998

Dollars in millions				
Enterprise fund	Year incorporated	Capital authorized in USAID grants	Grant amount received	Net asset value
Hungary	1990	\$72.5	\$56.6	\$28.2
Poland	1990	264.0	254.5	270.0
Czech-Slovak	1991	65.0	46.2	12.5
Bulgaria	1992	55.0	44.5	28.7
Russia	1993	440.0	165.0	89.6
Baltic	1994	50.0	31.1	22.4
Central Asia	1994	150.0	87.0	38.4
Romania	1994	50.0	35.2	28.2
Western Newly Independent States	1994	150.0	64.3	39.0
Albania	1995	30.0	16.0	14.0
Total		\$1,326.5	\$800.4	\$571.0

Source: USAID and enterprise funds.

Enterprise fund investment decisions are supposed to balance financial soundness with the funds' development mandate. Making investments where traditional financial institutions are reluctant to invest means some investments will not be successful, especially in the early stages of a fund's operations. However, by the end of a fund's operations, the successes are supposed to outweigh the failures. Individual investments made by the Russian fund illustrate the element of risk involved in enterprise fund investments.

- In 1995, the Russian fund wrote off the entire amount of its \$3.8 million investment in U.S. Global Health, which operated a western-style medical clinic in Moscow. The clinic failed because lower than expected revenues combined with start-up and operating costs depleted the firm's capital before it was able to make a profit.¹¹
- In 1996 and 1997, the fund also wrote off approximately \$3 million it invested in ZAO Giant, Ltd.—a supermarket chain in the Vladivostok

¹¹This investment was originally made in 1994 by the Fund for Large Enterprises in Russia, which merged with the Russian-American Enterprise Fund in 1995 to form the current Russian fund. The USAID Inspector General reported on the reasons for this investment failure in March 1997: *Audit of the Request for Review of the U.S. Russian Investment Fund's Investment in U.S. Global Health Limited*, Audit Report No. A-00097-003P (Washington, D.C.: USAID, Office of the Inspector General, Mar. 26, 1997).

and Nakhodka regions of the Russian Far East—before the company had ever stocked its stores with initial inventory. Fund officials said that it refused further support of the company when it became clear that the company had not put appropriate managers and financial controls in place to address serious operating and expenditure problems that were occurring in setting up the operation.¹²

- More recently, in 1999, fund officials feared that the fund's 1998 \$2.4 million investment in Lomonosov Porcelain—a porcelain tableware producer in St. Petersburg—could deteriorate considerably in value because the company's general director and senior managers opposed the fund's and other investors' takeover of the firm. However, fund officials said that they have since established a working relationship with the company's managers and expect, along with other investors, to assume control of the company shortly. The officials added that the company now has an excellent opportunity to significantly increase its sales, production volumes, and profitability.

Similarly, investments made by the Romanian fund also demonstrate the uncertain nature of enterprise fund investment operations.

- The fund's 1996 investment of \$471,000 in Multiprint—a commercial printing company in Northeast Romania—encountered financial difficulties due to factors such as late payments from the firm's debtors and the overall decline of the Romanian economy.
- The fund's 1996 investment of \$229,000 in Doriela—a Bucharest farm equipment services and leasing firm—performed poorly because of a decrease in demand. The fund reported that the purchasing power of potential buyers had diminished and that expected agricultural subsidies had not materialized in Romania.
- The fund's 1996 investment in Multicolor—a label and packaging plant in northeast Romania—demonstrated weak performance because of poor management, stronger than expected competition, and other factors. A fund-financed evaluation of Multicolor's difficulties led the company to negotiate the rescheduling of its debt payments, replace its general manager, and completely restructure its maintenance department.

¹²The original commitment for this investment was made in 1995 by the Russian-American Enterprise Fund.

Funds Are Complying With Increased Reporting Requirements

Since we reported on enterprise funds in 1994,¹³ USAID has increased fund reporting requirements due to concerns about the extent to which the U.S. government was systematically monitoring fund progress using a standard set of indicators. In 1995, the USAID Inspector General reported that USAID had not established a comprehensive set of specific objectives and measures by which the performance of the funds could be judged.¹⁴ In 1997, partly in response to these concerns, USAID strengthened its semiannual reviews of the funds by asking the funds to submit a "strategic framework matrix" providing data on fund activities in key areas, such as investments in small- and medium-sized enterprises and capital raised from other sources. The matrix also included other data, such as multiyear investment projections and break-even analyses.

According to USAID and State officials, the economic conditions in each host country, the length of time the respective funds have been operational, and the substantial operational latitude that funds were given in responding to their host-country situations make it difficult to establish clear and objective standards that can be applied equally to all of the funds. Therefore, USAID does not use the matrixes to hold funds to standardized performance targets or to make comparisons across funds. However, it does work with each fund to independently establish investment projections and target dates for breaking even.

We found that the funds are providing the information requested, although the information has not always been in the requested format. For example, while some funds may not have fully completed sections of the strategic framework matrix, they provided the required information in other reporting documents.

USAID and State officials told us that the additional reporting requirements had enhanced their ability to oversee the funds' activities. Russian and Romanian fund officials also told us that the current level of oversight is appropriate. They said that they have a responsibility to safeguard U.S. government funds that are provided to them in the form of grants and added that the reporting requirements are not burdensome. In addition, much of the information reported to USAID is data that the funds would

¹³[Enterprise Funds: Evolving Models for Private Sector Development in Central and Eastern Europe](#).

¹⁴[Audit of the Economy and Efficiency of Four Central and Eastern Europe Enterprise Funds](#). Audit Report No. 8-180-95-015 (Washington, D.C.: USAID, Office of the Inspector General, Aug. 25, 1995).

collect in their normal course of managing fund activities and is similar to information that private investors would expect to have available.

Conclusions

The enterprise funds in Central Europe and the former Soviet Union have supported private sector development in their host countries. Most have also helped strengthen financial institutions and encouraged economic reforms. A fund's success is largely dependent on its management's early involvement in the fund's operations and host-country legal, regulatory, and economic climates. Based on our analysis of financial and investment patterns in Russia and Romania, the enterprise funds in both countries have a continuing development role for the foreseeable future, and the overall need for investment capital in these countries continues unabated.

Determining whether enterprise funds will recoup their authorized capital is problematic; yet, U.S. officials expect several funds to recoup their authorized capital and have raised expectations that other funds will do the same. Finally, due to congressional concerns about U.S. oversight of the funds, USAID increased enterprise fund reporting requirements in 1997. We found that the funds are providing the requested information, and USAID and State officials told us the additional information has enhanced their ability to oversee the funds' operations.

Scope and Methodology

We reviewed the activities of all 10 enterprise funds in Central Europe and the former Soviet Union. To gain a first-hand view of fund operations, we also visited the Russian and Romanian funds' U.S. and host-country offices; toured in-country investment sites; and met with U.S., host government, and fund officials. These funds were selected based on congressional interest, to provide geographical coverage in both Central Europe and the former Soviet Union, and to offer contrasting fund sizes. We traveled to Romania and Russia in January 1999.

To determine whether enterprise funds are assisting private sector development and what factors have affected the funds' ability to carry out these activities, we interviewed cognizant officials and analyzed program documentation. Specifically,

- In Washington, D.C., we interviewed officials in the offices of the Department of State Coordinators of Assistance for Eastern Europe and the New Independent States, USAID's Bureau for Eastern Europe and

the New Independent States, and the Romanian fund's U.S. offices. We also met with members of the Romanian fund's board of directors and interviewed other private venture capital firm officials. We reviewed enterprise fund grant agreements, annual fund reports, fund semiannual review documents, and other reporting documents; USAID evaluations of enterprise funds; and USAID Inspector General reports. In New York City, we interviewed officials in the Russian fund's U.S. offices and met with members of the Russian fund's board of directors and other private venture capital firm officials. From our analysis, we determined the type and extent of enterprise fund activities that support private sector development in host countries as they progress from centrally planned to market-oriented economies as well as the critical elements that facilitated or impeded funds in executing these activities.

- In Russia and Romania, we interviewed enterprise fund senior managers and investment officers, reviewed the funds' investment and loan portfolios and fund technical assistance activities, and visited fund investment sites. We also discussed the fund's private sector development activities with senior officials at the U.S. embassies and USAID missions as well as host government officials. In addition, we attended the Russian fund's January 1999 semiannual review meeting.

To determine whether funds still have a role in private sector development, given other private investment and international donor efforts, we primarily relied on our case studies of the Russian and Romanian funds. We analyzed foreign investment flows in these two countries and discussed with U.S. officials the activities of other private investors and international donors there. We also interviewed Russian and Romanian fund officials, recipients of Russian and Romanian fund assistance, host government officials, and other international donors to determine the similarities and differences among the various activities of the funds, other investors, and other donors.

To determine whether the funds are likely to recoup their authorized capital, we discussed with U.S. officials their expectations regarding the ultimate financial outcomes of individual funds and discussed with private venture capital firm officials the practice of valuing international venture capital-type investment portfolios. We also reviewed annual fund reports, fund semiannual review documents, other reporting documents, and State and USAID documents.

To determine whether funds are complying with recent changes in USAID reporting requirements, we interviewed State and USAID officials and

reviewed enterprise fund reporting for the two most recent semiannual review periods.

Also, in response to a specific question from your staff, we identified the primary law firms that enterprise funds currently employ. This information is in appendix IV.

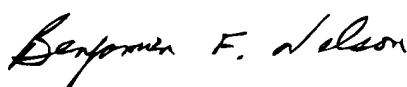
We performed our work from September 1998 to August 1999 in accordance with generally accepted government auditing standards.

Agency Comments

The Department of State and USAID provided written comments on a draft of this report (see apps. V and VI, respectively). State said that the report was a well-written and balanced analysis of the effectiveness of enterprise funds; USAID noted that the report detailed many accomplishments and development impacts of enterprise funds in Central Europe and the former Soviet Union. USAID also provided technical comments that we have incorporated, as appropriate.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies of this report to the Honorable Madeleine K. Albright, the Secretary of State; the Honorable J. Brady Anderson, the Administrator of USAID; and interested congressional committees. We will make copies available to others upon request.

Please contact me at (202) 512-4128 if you or your staff have any questions about this report. Other GAO contacts and staff acknowledgments are listed in appendix VII.



Benjamin F. Nelson
Director, International Relations and
Trade Issues

Contents

Letter	1
Appendix I Romanian Fund Investments, Loans, and Technical Assistance	28
Appendix II Russian Fund Investments, Loans, and Technical Assistance	30
Appendix III Romanian and Russian Fund Boards of Directors	33
Appendix IV Enterprise Fund Law Firms	37
Appendix V Comments From the Department of State	38

Appendix VI		39
Comments From the		
U.S. Agency for		
International		
Development		
Appendix VII		41
GAO Contacts and		
Staff		
Acknowledgments		
Tables		
Table 1: Enterprise Fund Capital Authorized and Invested and Technical Assistance Provided as of September 30, 1998		6
Table 2: Fund Capital Raised From Other Sources as a Percentage of Authorized Capital as of September 30, 1998		7
Table 3: Examples of Fund Activities to Strengthen Financial Institutions and Provide a Demonstration Effect		8
Table 4: Enterprise Funds' Operating Expenses as a Percentage of Authorized Capital for 1998		12
Table 5: Enterprise Funds' Grant Amounts and Estimated Asset Valuation as of September 30, 1998		18
Table I.1: Romanian Fund Direct Investment Program as of September 30, 1998		28
Table I.2: Romanian Fund Loan and Other Small- and Medium-sized Business Program Disbursements as of September 30, 1998		29
Table I.3: Examples of Romanian Fund Technical Assistance Projects		29
Table II.1: Russian Fund Direct Investment Program as of September 30, 1998		30
Table II.2: Russian Fund Loan Program Disbursements as of September 30, 1998		31
Table II.3: Examples of Russian Fund Technical Assistance Projects		32
Table IV.1: Enterprise Fund Primary Law Firms		37

Contents

Abbreviations

EBRD	European Bank for Reconstruction and Development
IFC	International Finance Corporation
IMF	International Monetary Fund
OPIC	Overseas Private Investment Corporation
USAID	U.S. Agency for International Development

Romanian Fund Investments, Loans, and Technical Assistance

As of September 30, 1998, the Romanian fund had made investments and loans in and provided technical assistance to Romanian businesses totaling about \$30 million. Most of the fund's investments (nearly \$23 million) were in Romanian small- and medium-sized businesses, including agribusiness and manufacturing of chemical products, technical rubber, and machine parts. The average size of the fund's 17 direct equity investments was about \$1.3 million, but over 40 percent of its investments was concentrated in two firms. The fund's largest investment was \$5 million in a paint manufacturing company, and the smallest was \$42,000 in a financial services firm. Table I.1 shows the fund's direct investments, including the recipient firms, types of businesses, and amounts invested.

Table I.1: Romanian Fund Direct Investment Program as of September 30, 1998

Name of firm	Type of business	Amount invested
Avicola Crevedia	Agribusiness	\$200
Comtel	Hotel development	1,300
Connecticut Manufacturing	Machine parts manufacturing	1,373
Doriela	Agricultural services	229
Dunarea	Textile manufacturing	500
Hobas Tub	Commercial pipe manufacturing	1,700
IPEC	Porcelain manufacturing	680
Logic Telecom	Telecommunications services	1,800
MotorActive	Leasing services	100
Multicolor	Label and package manufacturing	345
Multiprint	Printing	471
Policolor	Paint manufacturing	4,988
Regisco	Financial services	42
Rolast	Technical rubber manufacturing	4,125
TEC Miaco	Agribusiness	2,500
Titan Mar ^a	Construction materials production	800
Transdata	Telecommunications services	1,442
Total		\$22,595

^aIncludes purchase of Marmosim.

Source: Romanian fund.

As shown in table I.2, the Romanian fund had invested about \$6.2 million in loans and other lending programs. Over half (about \$3.2 million) of the

Appendix I
Romanian Fund Investments, Loans, and
Technical Assistance

investments were made through the fund's small- and medium-sized loan program.

Table I.2: Romanian Fund Loan and Other Small- and Medium-sized Business Program Disbursements as of September 30, 1998

Dollars in thousands	
Program	Amount disbursed
Small- and medium-sized loans	\$3,171
Micro-sized loans	2,430
Other small- and medium-sized business programs	554
Total	\$6,155

Source: Romanian fund.

The Romanian fund had provided about \$650,000 in technical assistance, most of which supported the fund's investments. Table I.3 offers some examples of technical assistance activities in which the fund engaged in support of its own investments or private sector development.

Table I.3: Examples of Romanian Fund Technical Assistance Projects

Name of firm	Description of assistance
Multicolor	Evaluated operations, finance, and human resource functions, and recommended changes in management personnel and inventory controls
Policolor	Trained managers and marketing and sales personnel in marketing techniques and product distribution
Rolast	Reviewed project planning and subsequently trained top management in methods for instituting organizational changes
Titan Mar	Provided strategic consulting and advice on operations and technology
Transdata	Evaluated human resources and helped establish performance-based incentive packages for managers and employees

Source: Romanian fund.

Russian Fund Investments, Loans, and Technical Assistance

As of September 30, 1998, the Russian fund had made investments and loans in and provided technical assistance to Russian businesses totaling about \$125 million. Most of the fund's investments were in small- and medium-sized businesses, but the fund had invested in some larger businesses as well. The Russian fund had made 28 direct equity investments totaling over \$97 million in businesses in Russia, ranging from agribusiness to telecommunications. The average size of the fund's direct investments was about \$3.5 million, but over half of its total investments was concentrated in seven companies. The fund's largest direct investment was \$15.5 million in a brewing and bottling company, and the fund's smallest was \$75,000 in a dental clinic. Table II.1 details the fund's direct investment program, including the recipient firms, the types of businesses they operate, and the amounts that the fund invested in them.

Table II.1: Russian Fund Direct Investment Program as of September 30, 1998

Dollars in thousands		Amount invested
Name of firm	Type of business	
Agribusiness Partners International L.P.	Agribusiness industry direct investment fund	\$5,000
Bitech Petroleum Corporation	Petroleum production	3,000
Dieselprom	Diesel engine manufacturing	3,660
Financial Center	Financial services	600
Frank's Siberian Supreme	Ice cream production	211
FunTech	Xerox copy operations and distribution of Xerox products	2,000
Genesee-Volkhov Connection, Inc.	Photo processing center	900
Independent Network Television Holding	Commercial network broadcasting	4,378
International Business Communication Systems, Inc.	Telecommunications	5,000
Interstom	Dental clinic	75
Invacorp	Pharmaceutical distribution	5,000
Lomonosov Porcelain Factory	Porcelain tableware production	2,375
Marine Resources Company International	Seafood production and fishing vessel refitting	8,250
Nizhny Newsprint Holdings	Newsprint and paper production	4,140
Phargo	Alphagraphics business services	2,500
Plyko L.L.C.	Plywood manufacturing	5,825
Polygrafoformenie	Packaging	2,799
Russian Petroleum Investor, Inc.	Publishing and information services for oil and gas industry	1,950
Saint Springs Water Limited	Production and distribution of bottled water	3,500
Segol RadioPage	Wireless messaging systems	2,500

(continued)

Appendix II
Russian Fund Investments, Loans, and
Technical Assistance

Dollars in thousands	Type of business	Amount invested
Name of firm		
StoryFirst Communications	Radio and television broadcasting	5,000
SUN Brewing Limited	Brewing and bottling facilities	15,500
Time	Women's clothing production	204
TsUM	Retail department store	500
U.S. Global Health	Medical clinic	3,770
Vita Plus	Pharmaceutical distribution	5,000
ZAO Giant, Ltd.	Supermarket chain	2,980
Zapsibinvest	Wood processing and packaging	970
Total		\$97,587

Source: Russian fund.

The Russian fund had made over \$25 million in small- to medium-sized loans, consumer auto loans, residential mortgage loans, and micro-sized loans to entrepreneurs. However, over 80 percent of the fund's lending activities were concentrated in loans to small businesses through the fund's partner banks. Table II.2 shows the amount of loans disbursed through the fund's various loan programs.

Table II.2: Russian Fund Loan Program Disbursements as of September 30, 1998

Dollars in thousands	Amount disbursed
Program	
Bank partner program and other small- and medium-sized loans	\$20,863
Auto loans	4,000
Mortgage loans	250
Micro-sized loan program	438
Total	\$25,551

Source: Russian fund.

The fund had also provided about \$1.7 million in technical assistance, most of which was in support of the fund's own investments. Table II.3 offers some examples of technical assistance activities in which the fund engaged in support of its own investments.

Appendix II
Russian Fund Investments, Loans, and
Technical Assistance

Table II.3: Examples of Russian Fund Technical Assistance Projects

Name of firm	Description of assistance
FunTech	Installed management information and financial reporting systems
Genesee-Volhov Connection, Inc.	Installed a management information system
Invacorp	Upgraded the company's existing management information system
Plyko L.L.C.	Installed a management information system and retained an engineering consultant to assist in the installation of a new production line and recommend operational improvements
Saint Springs Water Limited	Trained company employees in management development, strategic planning, and team building

Source: Russian fund.

Romanian and Russian Fund Boards of Directors

The members of the Romanian and Russian funds' boards of directors are private citizens of the United States or the host country. Although the members' backgrounds are varied, they generally have experience in areas such as investment banking and business or other relevant expertise.

Romanian Fund

The Romanian fund's board of directors is comprised of 10 members. The members include several attorneys and others who have experience in the financial sector or investment banking, two former U.S. ambassadors, and one current and one former Romanian government official. Information on all 10 board members follows.

Director and Chairman of the Board

Mr. Harry G. Barnes, Jr.
Director, Conflict Resolution Program and Chair, Human Rights
Committee, The Carter Center
Former U.S. Ambassador to India, Chile, and Romania

Director, President, and Chief Executive Officer

Mr. I. John Klipper
Former President of IVEX Corporation
Romanian native
Former insurance and venture capital company executive

Directors

Mr. Mugur Isarescu
Governor, National Bank of Romania

Mr. Robert D. Joffe
Presiding Partner, Cravath, Swaine, and Moore
Board Member, Lawyers Committee for Human Rights
Executive Committee Member, Association of the Bar of the City of New York

Ms. Judy H. Mello
President and Chief Executive Officer, World Learning
Former Managing Director, Cambridge International Partners

Appendix III
Romanian and Russian Fund Boards of
Directors

Mr. David M. Roth
Managing Partner, Levy & Droney

Ms. Ida F.S. Schmertz
Co-Chair, Volkov International Business Incubator and Training Center
of the Alliance of Russian and American Women
Principal, Strategic Investment International

Mr. Theodor Stolojan
Senior Economist, World Bank
Former Prime Minister of Romania

Mr. Richard N. Viets
Vice President and General Manager, Web Tools Division, Secure
Computing Corporation
Former U.S. Ambassador to Jordan and Tanzania

Mr. Gregory A. White
Chief Operating Officer, ValueQuest/TA
Former Executive Director, Massachusetts State Pension Fund

Russian Fund

The Russian fund's board of directors is currently comprised of nine members. The members include several individuals with experience in investment banking, venture capital, and financial services and others who have experience in business, law, and government, including a former assistant secretary of state and a former U.S. ambassador at large. The fund does not currently include any host-country citizens. Information on all nine board members follows.

Director and Chairman

Patricia M. Cloherty
President and General Partner of Patricof & Co., Ventures, Inc., a private
venture capital company operating in six countries
Former President and Chairman of the National Venture Capital
Association
Member of the Council on Foreign Relations

**Appendix III
Romanian and Russian Fund Boards of
Directors**

Director, President, and Chief Executive Officer

David A. Jones
Former President of Clarendon Capital, an investment banking and consulting firm
Founding Partner of Dougery, Jones & Wilder, a venture capital firm
Former Vice President of Citicorp Venture Capital Ltd.

Directors

Frank J. Caufield
General Partner and Founder of Kleiner Perkins Caufield & Byers, a venture capital firm
Former President of the National Venture Capital Association
Former President of the Western Association of Venture Capitalists

Arthur DelVesco, Cofounder of Wind Point Partners, a venture capital firm
Former Director of Republic Telecom Systems Corporation
Former Senior Investment Manager at First Chicago Equity Group

D. Jeffrey Hirschberg
Vice Chairman and Senior International Counselor, Ernst & Young, LLP.
Former Special Attorney to the Deputy Attorney General
Director of the U.S.-Russia Business Council

Robert D. Hormats
Vice Chairman of Goldman, Sachs International
Board Member of the Council on Foreign Relations
Former Assistant Secretary of State for Economic and Business Affairs
Former U.S. Deputy Trade Representative

Karen N. Horn
Senior Managing Director and Head of International Private Banking at
Bankers Trust Company
Former Chairman of the Board of Bank One, Cleveland, NA

J. Bruce Llewellyn
Chairman of Philadelphia Coca Cola Bottling Co.
Former President of OPIC
Former U.S. Ambassador at Large

Appendix III
Romanian and Russian Fund Boards of
Directors

Richard D. Turner
Executive Vice President of South Shore Bank of Chicago
Creator of Polish-American Enterprise Fund small loan program

Enterprise Fund Law Firms

As shown in table IV.1, four law firms provide the primary legal counsel for 9 of the 10 enterprise funds in Central Europe and the former Soviet Union.¹ One such firm—Weil, Gotshal & Manges of Washington, D.C.—is the primary law firm for five of the funds, while another firm—Arnold & Porter of Washington, D.C.—is the primary law firm for two funds. According to U.S. Agency for International Development (USAID) officials, only the Albanian fund retains no primary law firm and, instead, contracts for legal services on an as-needed basis. In addition to their primary law firms, most funds employ host-country or other specialized law firms for individual investment deals and a variety of other legal matters requiring specific expertise that is not available from one firm. According to USAID officials, the funds have employed over 50 different law firms on a variety of legal matters since they began operations.

Table IV.1: Enterprise Fund Primary Law Firms

Law firm	Corporate or business location	Enterprise fund
Weil, Gotshal & Manges	Washington, D.C.	Baltic Hungary Poland Romania Russia
Arnold & Porter	Washington, D.C.	Czech-Slovak Western Newly Independent States
Kirkland & Ellis	Chicago, IL	Bulgaria
McDermott, Will & Emery	New York, NY	Central Asia

Source: USAID.

¹Two additional enterprise funds that we did not include in our review—the Defense Enterprise Fund and the Southern African Enterprise Fund—also employ primary law firms. The Defense Enterprise Fund's primary law firm is Weil, Gotshal, and Manges of Washington, D.C., and the Southern African Enterprise Fund's primary law firm is Long, Aldridge, and Norman of Atlanta, GA.

Comments From the Department of State



United States Department of State
Chief Financial Officer
Washington, D.C. 20520-7427

August 12, 1999

Dear Mr. Hinton:

We appreciate the opportunity to review your draft report, "FOREIGN ASSISTANCE: Enterprise Funds Contributions to Private Sector Development Vary," GAO/NSIAD-99-221, GAO Job Code 711353.

The Office of the Coordinator of Assistance for Eastern Europe and the Office of the Coordinator of NIS Assistance reviewed the report and considers it to be a well-written and balanced analysis of the effectiveness of Enterprise Funds. The Department does not identify any errors or serious omissions.

If you have any questions concerning this response, please contact Mr. Donald Sheehan, Bureau of European Affairs, Office of East European Assistance at (202) 647-1183.

Sincerely,

A handwritten signature in black ink that reads "Bert Edwards".

Bert T. Edwards

cc: GAO/NSIAD - Mr. Michael Courts
State/EUR/EEA – Mr. Donald Sheehan

Mr. Henry L. Hinton, Jr.,
Assistant Comptroller General,
National Security and International Affairs,
U.S. General Accounting Office.

Comments From the U.S. Agency for International Development



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

August 4, 1999

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
National Security and International Affairs Division
U.S. General Accounting Office
441 G Street, N.W. - Room 4039
Washington, D.C. 20548

Dear Mr. Hinton:

I am pleased to provide the U.S. Agency for International Development's (USAID) formal response on the draft report entitled "FOREIGN ASSISTANCE: Enterprise Funds' Contributions to Private Sector Development Vary" [July 1999].

The 10 Enterprise Funds (Funds) develop private businesses that create employment and wealth and lead to growth in 19 transition economies in Central and Eastern Europe (CEE) and the New Independent States (NIS). They seek to preserve the capital provided in their grants through sound investment and management practices. In the cases of the Polish Fund, and some of the other Funds, the capital has helped create permanent institutions that will continue to strengthen the private sectors of these countries long after they conclude their investment activities.

Your report details many of the accomplishments of the Funds and we expect to be reporting more accomplishments over the next decade as the rest of the Funds complete their development work in the transition economies of CEE and the NIS. USAID appreciates the efforts of the GAO to capture the development impacts of this important element of USAID's program in the ENI region.

1300 PENNSYLVANIA AVENUE, NW
WASHINGTON, D.C. 20523

Appendix VI
Comments From the U.S. Agency for
International Development

2

Thank you for the opportunity to respond to the GAO draft report and for courtesies extended by your staff in the conduct of this review.

Sincerely,



Terrence J. Brown
Assistant Administrator
Bureau for management

GAO Contacts and Staff Acknowledgments

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Acknowledgments

In addition to those named above, Michael Courts, Lee Kaukas, Jim Strus, George Taylor, Bruce Kutnick, and Richard Seldin made key contributions to this report.

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